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No. 519

In the Supreme Court of the United States

OCTOBER TERM, 1959

MILDRED RITTENBERG AND BERNARD WOHL, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

J. LEE RANKIN,
Solicitor General,
CHARLES K. RICE,
Assistant Attorney General,
ROBERT N. ANDERSON,
CARTER BLEDSOE,
Attorneys,
Department of Justice, Washington 25, D.C.

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OPINIONS BELOW

The opinion of the District Court (R. 57–61) has not been reported. The opinion of the Court of Appeals (Pet. 30–37) is reported at 267 F. 2d 605.

JURISDICTION

The judgment of the Court of Appeals was entered on June 16, 1959 (Pet. 38). A petition for rehearing was denied on August 14, 1959 (Pet. 38). The petition for writ of certiorari was filed on November 6, 1959. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether annual payments made by a taxpayer to supplement rentals paid by a corporation owned by him in order to permit the corporation to build, and himself to manage, an apartment building, were deductible by him as ordinary and necessary business expenses or as non-business expenses.

STATUTE INVOLVED

Section 23(a) of the Internal Revenue Code of 1939 is set forth in the Appendix, *infra*, p. 6.

STATEMENT

In 1949 the taxpayer[1] entered into negotiations with the Federal Housing Administration for a commitment to insure a thirty-five-year loan which was to finance the construction of an apartment building, costing approximately $2,300,000 (Pet. 31, 35; R. 58). A corporation, wholly owned by the taxpayer, called Wohl, Inc., was formed to carry out the project and to own and manage the apartments (R. 58). One of the conditions of the F.H.A. commitment was that the ground rental to be paid by the corporation for the land upon which the building was to be erected would not exceed $9,000 per year. The land owners requested $12,000 rental per year for the ground and, in order to overcome this difficulty, the taxpayer entered into a separate contract with the land owners whereby he promised to pay $3,000 per year for thirty-five years out of his own funds in return for the land owners' agreement to lease the land for ninety-nine

[1] The taxpayers were man and wife, the husband being the party personally involved in the transactions described.

years to Wohl, Inc., at $9,000 per year for the first thirty-five years (Pet. 31, R. 58).

The land owners signed the lease with Wohl, Inc., the loan insurance was approved by the F.H.A., and the building was constructed. The taxpayer has been manager of the apartment building at a salary of from $13,500 to $15,000 a year since its completion in 1951. During the period in suit, the taxpayer was also manager of another apartment building owned by another corporation in which he was a stockholder (Pet. 31–32, R. 58–59). Under the private agreement made to secure the lease for Wohl, Inc., the taxpayer paid the land owners $2,250 in 1951, $3,000 in 1952, and $3,000 in 1953, deducting these sums from his gross income as ordinary and necessary business expenses (Pet. 31, R. 59). The District Court held that these payments were not ordinary and necessary business or non-business expenses of the taxpayer but were in the nature of capital investments or expenditures (R. 60–61), and the Court of Appeals affirmed (Pet. 30–37).

ARGUMENT

Upon the facts of this case the decisions of the courts below that the payments made by the taxpayer pursuant to his contract with the land owners were not deductible under Section 23(a) of the Internal Revenue Code of 1939 (Appendix, *infra*, p. 6) either as business expenses under Section 23(a)(1) or as non-business expenses under Section 23(a)(2), are correct and in accord with the statute and settled legal principles. The taxpayer urges (Pet. 20) that he was engaged in the business of managing apart-

ment buildings and that the payments in question were necessarily made for the purpose of creating a job opportunity. However, expenditures are not deductible under Section 23(a)(1) simply because they have some relation to an income-producing activity; in order to qualify, they must be incurred in the active conduct of the particular business involved. *McDonald* v. *Commissioner*, 323 U.S. 57; *Frank* v. *Commissioner*, 20 T.C. 511; *Peto* v. *Commissioner*, decided February 28, 1958 (1958 P-H T.C. Memorandum Decisions, par. 58,034), affirmed *per curiam*, 262 F. 2d 342 (C.A. 2). Obligations incurred to create a new source of income are not deductible as ordinary and necessary business expenses. *McDonald* v. *Commissioner, supra; Peto* v. *Commissioner, supra; Hammond-Knowlton* v. *Commissioner*, 19 B.T.A. 947. Cf. Treasury Regulation 118, Section 39.23(a)-15(f). Moreover, as the Court of Appeals pointed out (Pet. 34-36), the payments actually cannot be described as being predominantly for the purpose of promoting prospective employment, even if such a purpose were assumed to be sufficient for purposes of deduction. Rather, they were primarily incurred to enable the taxpayer to become the beneficial owner of an apartment "costing in the neighborhood of $2,300,000" (Pet. 35) and, in this sense, were non-deductible capital investments or expenditures. Even the taxpayer himself in his petition repeatedly states that without these payments the apartment could not have been built (Pet. 11, 12, 17).

Also, as observed by the court below (Pet. 37), the cases relied on by the taxpayer (Pet. 12-18)—*United*

States v. *E. L. Bruce Co.*, 180 F. 2d 846 (C.A. 6); *Dinardo* v. *Commissioner*, 22 T.C. 430; *Dunn & McCarthy* v. *Commissioner*, 139 F. 2d 242 (C.A. 2)—do not require a conclusion contrary to that reached by it. The present payments were not, as were the expenditures in those cases, for the protection of an existing investment or for the preservation of existing income from loss or diminution.

Further, as the Court of Appeals held (Pet. 35–36), the payments here do not qualify as "ordinary" within the meaning of Section 23(a)(1). Cf. *Welch* v. *Helvering*, 290 U.S. 111, 114; *Deputy* v. *duPont*, 308 U.S. 488, 495. For this reason, as well as for those discussed above, the taxpayer is likewise precluded from deducting the payments as non-business expenses under Section 23(a)(2). Cf. *Low* v. *Nunan*, 154 F. 2d 261 (C.A. 2). There is no conflict of decisions, and no question warranting review by this Court is presented.

CONCLUSION

The petition for writ of certiorari should be denied.

Respectfully submitted.

J. LEE RANKIN,
Solicitor General.

CHARLES K. RICE,
Assistant Attorney General.

ROBERT N. ANDERSON,
CARTER BLEDSOE,
Attorneys.

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*The record fails to show that the taxpayer's payments were in any way related to his continuation as manager.

APPENDIX

Internal Revenue Code of 1939:

SEC. 23 [as amended by Sec. 121(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798].
DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) *Expenses.*—

(1) *Trade or business expenses.*—

(A) *In general.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * * * *

(2) *Non-trade or non-business expenses.*—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.

* * * * *

(26 U.S.C. 1952 ed., 23(a).)

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